

Defining the Rich in the World's Wealthiest Nation

By David Leonhardt

They have become the most discussed social group in the United States. Yet few people acknowledge being a member, and there is little agreement about what qualifies one for inclusion.

They are the wealthy, and President Bush's current economic plan has thrust them to the center of attention. But whether one believes they should be soaked, or encouraged to create more wealth, even the terms of the debate are murky.

Some would include any family that makes more than \$100,000 a year. Others put the cut-off much higher, noting that a six-figure income alone is not enough to buy many houses in the biggest metropolitan areas. Still others ignore salaries and point out that all of the commonly used words for the well-off - affluent, rich, wealthy - are supposed to describe people's assets rather than their incomes.

"Today, wealth is much greater in its diversity," said George Fertitta, the president of Margotes-Fertitta, an advertising agency that specializes in luxury brands. "Unlike 20 years ago, the wealthy person isn't the kind person you could paint a picture of and say, 'That's exactly who they are.'"

By any standard, wealthy Americans find themselves in an unusual position, having enjoyed one of the most prosperous 20-year periods in history. The fortunes of many families that were already rich have soared since 1980, but so did the ranks of the newly wealthy, with the number of households worth at least \$1 million almost doubling to 4.8 million from the early 1980's to late 1990's, even after accounting for inflation, said Edward N. Wolff, an economist at New York University. Almost three million of the 130 million families filing tax returns in 2001 reported at least \$200,000 in income, up from 1.3 million in 1995.

In the past, surges of wealth created backlashes that led to the trustbusting era in the 1890's and the New Deal of the 1930's. But since the technology bubble burst almost three years ago, the wealthy have become perhaps the chief beneficiary of government policy.

"It would be totally contrary to history to have a speculative bubble, and turn around and reward the people who benefited the most," said Kevin Phillips, whose "Wealth and Democracy" criticized the rise of inequality. "The last time this happened, the wealthy got killed by the government, with the New Deal."

This time, attacks on the rich have found little traction. The party more sympathetic to the wealthy has won control of the White House and the Senate since stocks began falling and joblessness began rising in 2000. One possible reason the class-war criticism has not yet stuck is that defining wealth is come complicated that it once was. Some people have homes that have appreciated enormously in value, but they can't sell them without buying a new, similarly expensive home. High-earners who live in high-cost areas feel stretched. Lower earners who live in less expensive places don't feel poor.

The explosion in American wealth is often traced to the early 1980's, when a long bull market and a period of impressive growth began. But while the wealthy did well in the 80's, the major trend was the drop in the buying power of middle- and lower-income families, because of a stagnant minimum wage and high unemployment.

"In the 80's, it was not so much the top moving way ahead," said Jared Bernstein, an economist at the Economic Policy Institute, a liberal research group in Washington. "It was the bottom getting smashed."

In the 1990's, by contrast, inequality kept growing because the wealthy did fabulously well. Despite the decade's prosperity and the raises given to most workers, the top 20 percent of earners were the only group to increase its share of the nation's income.

Along the way, the distinction between highly paid people and those with large piles of capital became increasingly blurred. Today, salaries can beget fortunes, as deregulation and globalization have increased the opportunities for profits and pay in corporate America.

"The one really conspicuous change is that it's possible to become a wealthy person just by what you earn for doing your job," said Robert Frank, an economist at Cornell University. "That wasn't very often possible 25 years ago."

From 1997 to 2001, the top five executives at the average American company split \$31.6 million in profits from exercising stock options, according to "In the Company of Owners" (Basic Books, 2003), a new study of options. This sum does not include their salaries or bonuses.

At most companies, the rewards of the stock-market bubble flowed overwhelmingly to top executives. But in technology companies, many rank-and-file workers famously made enough to be considered wealthy. Even excluding the top five executives, the average employee at a group of 100 big technology companies made \$425,000 exercising options from 1994 to 2001, according to "In the Company of Owners."

Oddly, as the ranks of the well-off have grown, relatively few people identify themselves as affluent. In a 1993 New York Times/CBS News poll, 91 percent of people in families making at least \$75,000 a year (about \$100,000 in today's dollars) described themselves as middle class.

The issue is more than mere semantics in many places. The costs of housing, transportation, child care and tuition can quickly make a six-figure income seem middle class, even if it permits a living standard far above the national average.

The tax cut Mr. Bush proposed last week offers its own definitions of wealth. The truly wealthy are the small group of Americans who own significant amounts of stock outside of 401(k)'s and other tax-deferred retirement accounts. They would no longer have to pay taxes on many of their stock dividends, and this change would account for about half of the plan's \$674 billion cost in lost taxes over 10 years. In 2010, they also won't face estate taxes, a feature of the 2001 tax cut that is set to disappear in 2011, but which Republicans want to make permanent.

The reduction in taxes under the president's plan will make the economy more efficient, said Mark M. Zandi, the chief economist of Economy.com. "But," he added, "it's clear that the direct benefits will accrue to the top sliver of the population."

Imagine a high-income family owning \$10 million in stock that gives its members \$200,000 in dividends every year. Before the 2001 estate tax cut and before any prospective elimination of taxes on dividends this year, they would have paid federal taxes on their dividends every year, and their heirs would have lost about half of the fortune to the estate tax. In all, the heirs would have received \$5.6 million in 2010, assuming the dividends were reinvested but the stock did not increase in value.

Under the new proposal, combined with the 2001 law, they might not have to pay dividend or estate taxes and would instead inherit \$12 million.

The next level is the group that makes more than \$110,000. Exempt from some or all of Mr. Bush's proposed increase in the child credit, which would mainly help the middle class, this

group would benefit significantly from the decline in tax rates, but would not fare as well as people who receive large amounts of unearned income from dividends.

Under current law, a provision known as the alternative minimum tax, originally intended for the very rich, will increasingly hit families making salaries in the low six figures. This tax prevents families from taking deductions for children and state and local taxes, among other things.

How all this will play out politically is not yet clear. The storm of criticism of Mr. Bush's plan from Democrats last week - that it amounted to an attack on the middle class - showed they believe they will gain by opposing the wealthy. The Republicans believe that taking less from the rich will help stimulate the overall economy, as well as shore up a powerful constituency.

The winner of this struggle will help determine whether the next 20 years will be as good for the rich as the last 20 were.

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